

# **Social Policy** *in* **China**

Edited by  
**YANG TUAN**



**SOCIAL POLICY RESEARCH CENTRE  
INSTITUTE OF SOCIOLOGY  
CHINESE ACADEMY OF SOCIAL SCIENCES**

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## **Part I**

### **Social welfare and Social Policy**



# **Social Insurance Reform**

## **– Rethinking and Redirection**

*The following is a translation of the general report, entitled the Reform of China's Social Insurance System, conducted by a project team for Social Insurance Research of Chinese Academy of Social Sciences (or CASS).<sup>1</sup>*

Twenty years on since the mid 80's of the last century when the reform in social insurance system got started, it has at length begun to pay off. The official documents that underpin the legislation and regulations necessary for the new breed of system have one after another come into being. The Resolution of State Council on Unified Retirement Programme, The Resolution of State Council on Medicare for Urban Employees, Regulations for Unemployment Insurance, and Regulations for Social Insurance Levy are some of the important government papers concerning the social insurance. Minimum Living-Standards for Urban Residents is yet another that would, together with others, underscores the welfare programmes that provide public assistance to the poor. Also significant is Basic Social Security for and Re-employment of Redundant Employees in the State-owned Enterprises, a joint decree of State Council and Central Party Committee (or CPC), which addresses the specific circumstances of the period.

With all these official documents made public at the turn of the millennium, a brand new system for all urban residents, encompassing social security, unemployment insurance, and medical care, as well as welfare programmes, have finally come to take shape. So magnificent is the system, given the time taken and efforts made, that it really leaves one close to the moment of tears, sadly out of anything but joy, when realising that nobody has their eyebrows raised. The truth of the matter is that the system falls well short of social expectation. For all practical purposes, it should not have been so surprising, as the reform itself was flawed right at the outset, and on which all sorts of brains would find no difficulty to converge, regardless of their different shapes.

Empirically, our three-year-long investigation has revealed that no one in the category intended by the system, that is, the government, enterprises, and

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<sup>1</sup> The report was written by Jing Tiankui, Yang Tuan, Tang Jun, Muo Taiji, and Shi Yuxiao. Also, joining the discussion on the report were team members as Sun Pingyao, Guan Xinping, Lu Xuejing, and Yan Weimin.





individuals, seems happy with and thus ready to embrace it. Insofar as individuals are concerned, they are by and large sceptical, which is, indeed, consistent with the survey in Social Blue Paper 2000, where 60% of people polled expressed their dissatisfaction over the system. The most disturbing problems that from time to time irritated the households and the individuals alike were in turn physical illness, joblessness, and lower than subsistent family income. In fact, the two much-touted issues of 1999 – insufficient aggregate demand in domestic economy and FaLunGong event, have much to do with this ill-bred regime of social insurance.

Meanwhile, domestic enterprises are gruelling at the request to live up to their part of social security obligation via payroll taxes that have been ratchetting up all along. The increment required by the regulations concerned in this first round of the reform per se, for instance, has well exceeded 5% of the total wage bill, bearing in mind that such an increase is rolling on top of the social security burden that has already reached its critical level. Yet, anyone who would like to entertain his/her thought with some educated guessing that the government would somehow fare a bit better, since the reform is after all its own brainchild, should think again. Tens of billions of domestic cash have to be sourced out of the state coffer just to make the system's ends meet. In 1998, for example, there was a shortfall of over RMB 5 billion on the item of retirement programme alone, and that number was more than doubled the year after.

Doubtless, such an awkward outcome makes the rethinking of the first round of the reform inevitable. Three years of investigation, in which ideas from broader society, including governmental departments concerned and social organisations, have been heard, help us arrive at current consensus. That is, the flaw of the system does not lie in practice, nor in actual operation. Rather, it goes way back to the very beginning of the systemic design – the offspring of the misunderstanding of social insurance regime. Admittedly, such a conclusion, for various reasons, is far from rigorous. Nonetheless, the real aim of the study is, hopefully, to bring about a broad-based public debate, not least because the issue of social insurance is far too important to be left in the hands of a few in the group of “social elite”.

## **1. Systemic Design Vs. Actual Operation**

### **1.1 Social Security System**

Currently, the system has adopted the model of so-called “combined arrangement”. In other words, the arrangement combines the retirement programme organised on a pay-as-you-go basis – the payroll taxes of those working today pay for the benefits received by the elderly today, and what is called “fully funded system” where each individual's pension is supported by its own

contributions. The rationale behind such an arrangement is said to anticipate the much-predicted peak of ageing population around the year of 2005 and adapt to the new circumstances amid the market-based transition. Nonetheless, such a design contains a serious misconception of such factors as the economic capacity, an ultimate shift of policy target, government's obligation, and the incidence of domestic labour markets.

Insofar as the social security is involved, the system on “pay-as-you-go” basis has been broadly accepted internationally, even though the “fully-funded system” of pension scheme offers a better deal and thus attractive to governments. The reason for this is simple – given that no accountable government could possibly afford to disregard the interest of the groups that have already reached the age of retirement and over, the double loaded burden, upon the shift of the arrangement, has to be shouldered by the younger generation. Not only do they have to assume the lofty obligation of elderly support, but scramble a reasonable comfort for their own future nests as well.

Either way, there would be at least one generation that goes under. Such a long-attested economic principle, however, has been grossly ignored by our valiant government in the drive to grab the trophy of brilliancy in the worldwide reform of social insurance regimes. After all, the speedy advancement of the economy will shore up the reform. Or will it? The upshot of shifting to “combined arrangement”, where the elderly rests with the old while the young races to the new, is an up-rocketing of payroll tax rate that has been on the blink of the red. And with it, the blueprint of rapid growth paying for the cost of reform has been shattered utterly into a foggy pipe-dream.

At the other end of the system, moreover, the average replacement rate – the proportion of the social security benefits to pre-retirement income, remains at the level that is as high as over 80% of the labour compensation upon retirement. Such a rate would probably champion the world community, but the alternative cost of obtaining such a championship could also be staggering, posing an insurmountable problem for a developing economy like China's. The underlying explanation, however, has to be traced back to the command regime where the original programme was first created.

When the regime was running on the low compensation arrangement – a little over subsistent wages, it is quite understandable that the average replacement rate at that time would reflect subsistent living standard, meaning, equating the benefits similar to pre-retirement income. As the economy moved on, higher labour compensation tagged along. The average rate, however, would not budge. When this is compounded by the unstoppable upsurge in the pre-retirement wages and salaries of those erstwhile working masters, it becomes a corollary that the crisis will ensue. In practice, then, the new programme blew out merely within one year

of operation, as the actual outlay far exceeded the ex-anti budget expectation.

Doubtless, the entire exercise was originally purported to protect those working today when they move to the bracket of the old, without making the present elderly worse off. Due to the perverse incentive provided by the ill-considered design, however, the ultimate beneficiary shifts to the fresh retirees through their rash for early retirements, followed by sudden surge of their pre-retirement compensations so as to capture the benefits rendered by the high replacement rate. Meanwhile, the pension scheme hollows up becoming an empty shell, as the already meagre contributions are taken away to plug up the abysmal hole in the retirement programme. Not surprisingly, the apparent malpractice has been broadly blamed for the breakdown of the system. In the real, however, the scapegoat was set up from the way in.

Thirdly, ever since the reform started, there has been one important issue that is yet to be addressed, but that could possibly reshape the complete design of the system. That is, where does the responsibility of government lie? Specifically, how far should such a responsibility go in the provision of social security service? The more, the better, one would like to think, given we are living in the world of scarcity, but where does the resource come, again in this world of scarcity? The system, propped up solely by the government, promising the same or better living conditions after retirement, will certainly be out of reach in the fiscal commitment. Rather, it is the matter of striking a balance.

In fact, the similar system prevailing at present in most other countries or regions is using some kind of compound model with multiple components. In other words, the system generally consists of government retirement programme funded by payroll taxes, pension scheme organised by employers or unions, and commercial life insurance invested by households or individuals. All these, together with other private investments, would probably keep those retirees' life styles unchanged. Amongst them, government retirement programme on "pay-as-you-go" basis is by and large maintained at some level of basic requirement. And this has been a popular trend in the reform of social insurance across the world.

On the face of it, the reform in China has been moving in the same direction. In practice, however, the social security system here is entirely buttressed by the publicly funded retirement programme. This is because, for one thing, the traditionally parental government has taken too much the responsibility that is virtually beyond its capacity. For the other, the payroll tax's burn has reached so high the level (over 20% by employers and over 10% by employees) that there would be almost no resources left for investment in the "fully funded system" of pension scheme and commercial life insurance. And what's more, the lack of legislation in the scheme is also one of the major obstacles that prevent it from being functioning properly.

Finally, the rationale behind the on-going shift of the arrangement, as stated previously, is founded on the popular belief that the system organised on “pay-as-you-go” basis will not be sustained in the near future, as “less paid with more go” would become the reality along with the population ageing. Such a conventional wisdom, insofar as we are concerned, fails to take into account the country’s specific circumstances, or the incidence of domestic labour markets.

One single most important factor that precipitates the ageing process in the society has been the policy of population control. Nonetheless, its implementation between urban and rural areas has been so different that it has virtually created some sort of two-tier society in terms of demography, where two likely peaks would hardly be synchronised. As the shortage of labour supply in urban areas pushes up the wages, so would the influx of rural migrants increase? Given the sheer size of the rural population (over 60% of the total), and provided appropriate policy measures, it is quite possible that the ratio of recipients to contributors in the system can be maintained at some stable level, long enough for it to get over its difficult period.

## **1.2 Unemployment Insurance**

Comparatively, domestic unemployment insurance has been better positioned in terms of the perceived international standard. That is to say, the insurance is in general modelled upon the current international practice, if it ever exists. It is running on the basis where compulsory premium is levied on all employees who will in turn be entitled to the claim of the benefits for as long as 24 months once dropped out of the workforce. Again, like that in the social security system, misunderstanding of the insurance has underpinned its choice of models.

According to *Global Social Insurance System – 1995*, up to the year the book was written, there were only 52 out of 165 countries and regions surveyed, less than 1/3, that had adopted similar models of unemployment insurance. Given the problem of unemployment has become some kind of pandemic, plaguing most countries of the world at present time, what on earth is the reason that so many countries turn their backs on the ready-made model in tackling their unemployment problems? The explanation could not be more straightforward – the underlying assumptions on which the model is built are rarely fit for the country- or region-specific.

In its application, for example, the model has the time length of the benefits payoff lasting from 6 to 18 months. In other words, it assumes that most of the unemployed would find, or at least be able to find, a job, within that time period. Such a strict condition would only be appropriate to the frictional jobless in a labour market with a rather complete and stable structure. For those economies



whose unemployment is characterised as rather chronic or structural, and/or those that have been undergoing restructuring transition, however, the usefulness of the model would be called in question.

Tough as it is, the economy here in China has been struggling to live through its historical transition where one unhappy fallout has been a flood of unemployment made up mostly of the structurally mismatched. In the minds of labour market experts, the number of the jobless in 1998 was ranging between 15.4 – 16 millions, as high as around 8% of its labour force, which was certainly different from what the politicians would like the world to hear as merely 3.1% registered. Worse, amongst them, males over 45 years young and females over 40 are basically seen as outcasts of the current labour markets. Given all these home-grown twists, the unemployment insurance of the sort, like most other economic models taken straight from the West, will not be much helpful without being drastically tailed to the home use.

What's more, one of the beauties of this "bureaucratic economy" is that at the time when it, by a decree or something, crops out heaps of redundant human resources, quite magically, the numbers will somehow manage themselves never to show up on any economic chart. While the politicians' resumes are kept safe from being sullied, the unemployment insurance that has already been short enough to go around will take the strain. As for economists, such the redundant is often coined as "the underemployed", for they, one way or another, still have some unfinished paperwork to do with the former bosses. For this reason, they do not technically belong to the category of unemployment, and thus are not entitled to the claim in the unemployment insurance.

In the early 90's when the phenomenon of "underemployment" first popped up, it did not seem to be a big deal to the government. No surprise, there was no long-term measure created for it, except for some political gestures, like visiting the poor at a few show-times of a year with a full TV coverage. Starting from 1997 when the ominous sign of the problem became clear, the government was then truly in a hurry, scrabbling up some contingency plan that would provide some living allowance as sort of emergency relief. From the moment on, however, the real trouble was in the making, thanks greatly to this ill-considered plan funded jointly by governments of all levels, enterprises, and local unemployment service agencies.

Given the fact that the allowance was not well targeted – dishing out equally on the head count, not only did those in need hardly feel relieved, but also the plan was quickly running out of the steam – short of the wherewithal, as the reform got deeper. The cash-strapped authorities had merely two choices, either to dig into the skimpy savings of unemployment insurance or to turn a blind eye to the suffering of once frontline comrades. In the balance between them, however, the savings

scantly got much of a say. Indeed, the current unemployment insurance has been in the state of impotency – huge injection (i.e. RMB 6-7 billion annually) without much efficacy. No argument, a tricky tinkering stunt of political expediency will not do the job. To rejuvenate it, the complete overhaul is needed.

### 1.3 Medical Care

The objective of domestic Medicare system is to provide a basic need for medical services to all urban employees with the principle of “low standards with wide coverage”. Similar to the social security system, the Medicare is also running on the basis of “combined arrangement”. And similarly still, the problems are on the lurk both within the arrangement and its actual coverage.

With respect to the arrangement first, the adoption of “fully funded” personal account in social security system is quite understandable, given the predictability of its payoff period. Whereas the opposite is rather true in terms of payoff period in medical care, that is, highly uncertain, the usefulness of combining the “fully funded” in the arrangement could not be more dubious.

On one hand, given the unpredictability of requiring medical services in terms of both timing and resource involved, and provided the fact that there are always fewer sickies at any point in time, the notion of “all for one and one for all” reflected in “pay-as-you-go” arrangement is probably the most efficient principle that one could possibly have insofar as social costs are concerned. The equal opportunity afforded by the arrangement, which in effect leaves everyone’s life in the save hands, would be more than enough to offset the possible unequal outcome, as few would like to level the outcome at the expense of their healthy beings.

On the other, the “fully funded” personal account system does not seem to make much of sense economically as well as socially. For the chronically ill, “pay-as-you-go” appears the only way to be, as their accounts are never “fully funded”, whereas for the physically fit, their contributions are always in full, yet, no one can set a hand on these accounts, either for investment or for some kind of life-saving crusade. Meanwhile, more public injection is needed just for the combined arrangement up and running. Such a heavy injection has seen in recent years that the levy for the Medicare per se accounts on average for around 10%-20% of the total wage bill, and its growth rate has been running at 2-3 times ahead of the wage increase. Funny as it is, though, the social and economic costs thus induced become increasingly unacceptable.

Turning to the coverage of the system, what the principle of “low standards with wide coverage” effectively means is really the first part, that is, “low standards”, with the following merely serving as a diplomatic decoration. Why is that? The actual coverage is already dictated by its real intention of “all urban employees”.



Given the present state of the economy, the system has for all practical purposes taken out all those truly in need – children, the elderly, and the jobless, the groups of being most susceptible to illness. “Low standards” sounds home.

With only part of the society enjoys publicly funded medical care, the “oasis syndrome” occurs. The system, like a little piece of green land in the middle of desert will be eroded, and in time, under the catalytic agent of family cells, will disappear into a piece of memory. Indeed, the system, ever since it became a newborn in this land of upheaval, has been bedevilled by its inherent problems that go with its birth. This may, in one way, explain why as many as over one half of the cities (56%) have yet to decide their detailed measures to implement the system. Meanwhile, two years of invaluable time have elapsed forever.

### 1.4 Welfare Programmes

The welfare programme, which affords public assistance, or minimum living standards, to the poor, has so far been one of the better designed amongst all those that have come out of the on-going reform. Nonetheless, some deficiencies remain in both operation and design. The programme was implemented on Oct. 1, 1999, immediately after the official document of Minimum Living-Standards for Urban Residents made public in September that year. Although the document clearly states, “Every non-agricultural resident whose average household income is lower than the minimum living standards in his/her local area is eligible for the basic material assistance provided publicly by the local government”, it starts to get twisted as soon as it becomes real.

One of the deviations starts with the identification of welfare targets, where bureaucratic red tape has been at play, being a real culprit. For many urban residents, their average household incomes are indeed below the minimum necessary, yet they are not eligible for the programme. The reason is simple, as these are either unemployed or underemployed (i.e. still belonging to some outfits of state-owned industries), they should be covered by unemployment insurance or living allowance (stated previously), regardless of whether the benefits being materialised or not. Given the serious problems plaguing the social insurance system, many programmes are hardly functioning properly. The upshot is the creation of a new generation of the urban poor.

Moreover, the programme fails to tackle the composition of the households below the poverty line. A family of four sturdy adults with an average minimum-living of RMB 500 per month, for example, will obviously be better off than that of four including one toddler, one grandma, plus one disabled. Because of the single-minded approach, the programme in this area, often seen as rather part of problem, might, as it goes, create more troubles than it solved.

In addition, the welfare programme is at present jointly funded by the municipal and district councils, with little attention paid by their provincial superiors, let alone the central government. As many municipal and district economies remain subdued in recent years, they have been, as a result, trapped in some kind of vicious circle. The less activities in their economies, the tighter the budgets, and yet, the higher the claim on their welfare programmes, for it becomes more likely for those in need to go further below. Under the circumstances, many local authorities in striving to make their ends meet cannot but lean on the legitimate red tape, rather than to see eye to eye with their bosses at the top of the hierarchical system. The current structure of programme financing may well underlie the apparent operational problem of identifying welfare targets.

According to a rather conservative estimate of some experts, currently, there are approximately 12-15 million urban residents living below the poverty line. However, only 2.8 million of them, less than 1/4, have been sheltered under the umbrella of the welfare programme since it came into being in 1999. Social stability is indeed at stake.

## **2 Underlying Ideas**

The systematic breakdown of the social insurance system into its component parts has so far been quite helpful for us to make clear that the real problem with the system lies in its ultimate design rather than what it seems as being operational. Yet, what has been missing is the complete picture of the system. No matter, as any design, be it partial or systemic, will invariably be shaped by some basic thinking or underlying ideas in terms of fundamental principles, ultimate objectives, incidence of the regime, and methodology. Admittedly, here is no space for further elaboration. Suffice it to raise some important issues vis-à-vis a systemic design for possible future discussion.

### **2.1 Fundamental Principles**

The broader understanding of social insurance regime, which has been widely accepted internationally, argues that the regime is rather an independent socio-economic institution that, together with the economic and other institutions, serves to meet the needs of human society. With that in mind, the notion of regime broadens far beyond purely economic wants – not only does it provide the insurance in the form of material wellbeing, but also that of services, rights, culture, or even spiritual wellbeing.

However, a rather narrow view of the regime has been embraced domestically, regarding it as an integral part of the economic system. As such, its establishment





is intended to serve the end of the markets. Not surprisingly, the primary objective of the design would embody such a fundamental principle with the judgement of market efficiency. Although it does try to take into consideration the notion of fairness in the normative approach, it cannot shy away from the fact that it fails to address adequately those social issues involved in the regime. Nor is it capable of arriving at a real state of economic efficiency. Why is that?

In the ideal world of perfect competition with no existence of externalities whatsoever, it is possibly that the market efficiency can accommodate the notion of fairness that would lie, theoretically, on the contract curve somewhere hinging on certain outcome of social negotiation. On the piece of land where China sets its foot, however, the condition is not that pretty – not only is it far from the ideal, but also falls well short of a complete market structure as it is yet on its way. By focusing purely on market efficiency, to say the least, it fails to incorporate into its approach the social costs – the negative externalities produced by the markets.

## 2.2 Ultimate Objectives

In general, there should be no problem to equip any design, under certain principle, with its own objective or objectives. Still recognising that the scarcity has been a constant reality, some trade-off has to be made for the latter. But it could spell trouble when there are too many objectives, or simply untenable ones. Unfortunately, that may depict the current system of social insurance. Nevertheless, the fact that the system was born in a period of turbulence amid economic and social transition may lend itself readily to the defence of the designers who have been on the firing line, bombarded by all the unexpected.

Yet, for a moment, they might have been lost to the land of plenty – the system that breathes life into their ideas has its multiple objectives that are virtually all-inclusive in nature. Being an integral part of the economic regime, for example, the design should include the current goal of obtaining economic stability, while setting aside the scarce resources available for the future target, preparing for the advent of ageing population. Having on its shoulders a heavy burden of looking after the underemployed and the unemployed, it, none the less, soldiers on to the rescue of the cutback in the state-owned sector by taking on the re-employment programme for the sector's spare capacity. Not only is it assigned the role in the popular Keynesian game of puffing up the lacklustre economy, but also expected to be a major player in the "mission impossible" of contributing to the growth of domestic capital markets.

What's more, the word of "basic" in the parental tradition may constitute a slightly different meaning. Rather than denoting the notion of subsistence, as it should be when talking about social security, it generously stands for some necessary conditions that would be expected to scale up with the growth of